RESEARCH BRIEFING

The Hidden Opportunities in Lending to Delinquent Consumers

BUSINESS CHALLENGE

The South African lending industry is grappling with a substantial and persistent issue – an extraordinarily high consumer delinquency rate. As of Q1 2023, a staggering 50% of consumers have one or more missed payments on their records, reflecting a consistent pattern that has become a widespread problem affecting the lending industry.

The impact of this issue is twofold. Firstly, it presents a significant financial risk to lenders due to potential losses on outstanding balances. Secondly, it indicates an unmet need among consumers for more sustainable lending solutions that cater to real-life challenges and unexpected events.

In light of these persistent challenges, TransUnion initiated a research study to delve deeper into the issue. The research addresses several pivotal questions that are not only relevant but essential to understanding and addressing this prevalent problem:

- How does a currently delinquent borrower perform on a new product?
- Could providing additional liquidity to a delinquent borrower assist them in the long run and benefit the lender?
- How can the insights obtained from this research be practically applied in lending to delinquent consumers?

By exploring these crucial questions, TransUnion aims to comprehend the dynamics of delinquency more accurately and uncover the hidden opportunities for lenders in serving delinquent borrowers. The ultimate goal is to enable lenders to devise effective strategies that assist in recovering and managing delinquent accounts, while also providing new, more flexible liquidity options that can help borrowers overcome short-term financial difficulties.

THE STUDY

- TransUnion studied borrowers who originated non-home loan credit products between April 2021 through to March 2022.
- For the purpose of comparison, we studied borrowers who were current in the month prior to origination and borrowers who were delinquent in the month prior to origination of the new credit product.
- We assessed the opening limits/ loan amounts on new originations, risk profiles of delinquent borrowers and compared them to borrowers who were current.
- We then analysed the performance of both current and delinquent borrowers twelve months post origination that varied by risk profiles.
- We also analysed delinquent borrowers who originated a personal loan in 2021 with the following exclusions:
  - → Borrower had four or more missed payments on any account in wallet
  - → Borrower had a charge-off in the past two years
  - → Borrowers who have a CreditVision (Generic) score of 725+
- It is crucial to understand if these borrowers cured on their existing delinquencies three months after originating a new personal loan and whether they were able to stay current on the new loan over a twelve-month period.
- We analysed trended credit data and credit attributes that enabled us to build a predictive model that identifies borrowers who are likely to perform after receiving additional liquidity from lenders.

KEY FINDINGS

- Between April 2021 and March 2022, approximately half of the 4.7 million South African borrowers who sought non-home loan related credit products were classified as delinquent in the month prior to that origination.
- Non-bank personal loans emerged as the predominant funding source for these delinquent borrowers, regardless of their delinquent product holdings.
- A significant majority of these delinquent borrowers (91%) were classified as below prime, indicating higher inherent risk at the time of origination.
- Delinquent borrowers with fewer existing delinquencies and lower delinquent balances demonstrated better performance on new credit products.
- Of the delinquent borrowers who originated a new personal loan in 2021, about 30% managed to cure their existing delinquencies and maintained current status on their new loan.
- Borrowers who stayed current on their new loans typically had more open accounts, longer credit histories, and lower delinquent balances.
- Lender loyalty had an impact, with one in five consumers opening a personal loan with the same lender they were delinquent on and remained current on their new loan.
- The impact of credit education was found to be significant, with consumers who monitored their credit being 1.8 times more likely to cure and remain current on their loans.
- By combining trended credit attributes, we built a proof-of-concept predictive model that can better predict performance for delinquent borrowers. In the highest decile of our model, the delinquency rate on newly originated loans is 8%, which is notably lower than the average delinquency rates observed for loan products in the market within similar risk score bands.

Non-bank personal loans are the primary source of funding for delinquent borrowers regardless of delinquent product holdings

Delinquent product at t-1	Origination product type		
Non-Bank Personal Loan	Non-Bank PL 74%	Bank PL 11%	Clothing 9%
Clothing Line	Non-Bank PL 46%	Bank PL 20%	Clothing 19%
Bank Personal Loan	Non-Bank PL 66%	Bank PL 17%	Clothing 9%
Retail Instalment	Non-Bank PL 56%	Retail Instalment 17%	Bank PL 13%
Retail Revolving	Non-Bank PL 47%	Bank PL 23%	Clothing 13%

Source: TransUnion South Africa consumer credit database

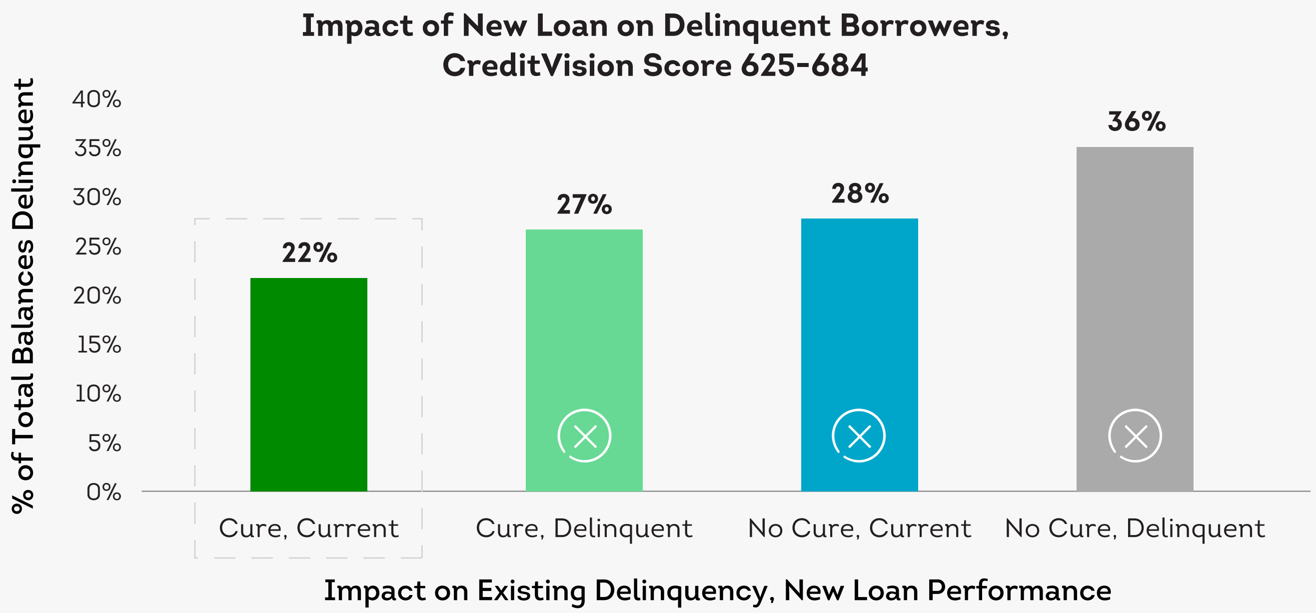
Of the 35% that cure, most also perform well on the new loan

Performance on new loan, 12 months post-origination	Borrower cured on 1+ delinquent account 2 months post-origination		
	Yes, cured	No, didn't cure	**All consumers**
Current	30%	49%	**79%**
Delinquent (1+ MIA)	5%	16%	**21%**
All consumers	**35%**	**65%**	**100%**

The group in green is who we want to lend to!

Source: TransUnion South Africa consumer credit database

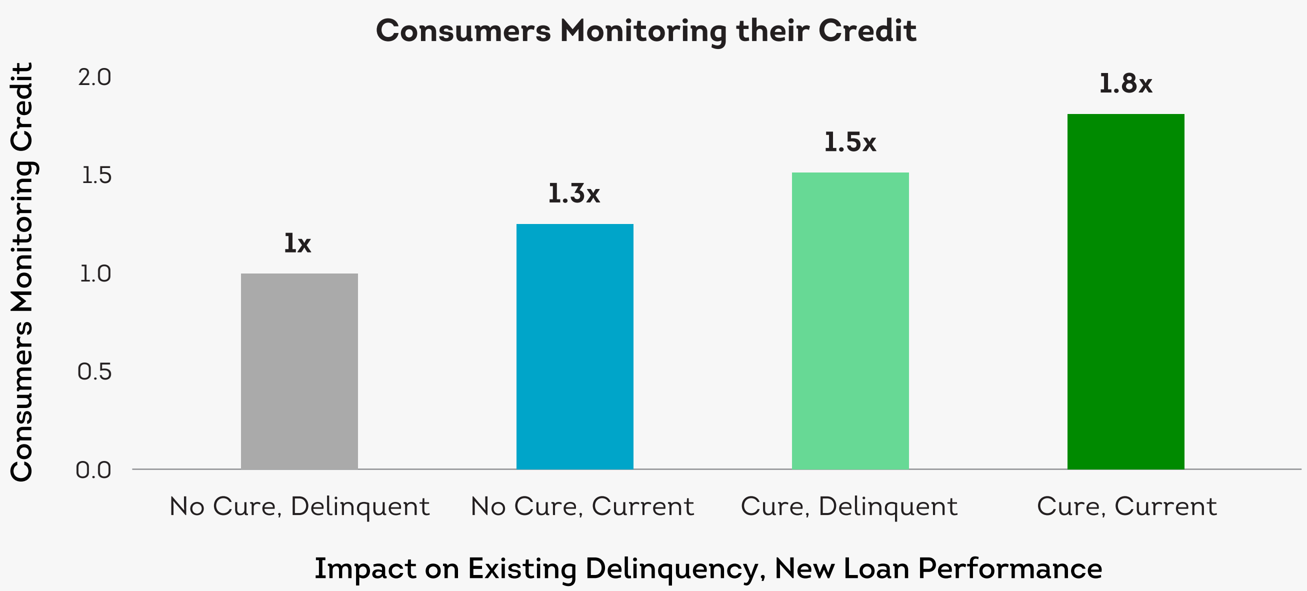
Consumers with fewer delinquent balances are more likely to remain current on the newly originated account



Performance measured at 12 months, ever 1+ MIA on newly originated loan

Source: TransUnion South Africa consumer credit database

Credit education matters! Consumers who monitor their credit are most likely to cure and remain current



Source: TransUnion consumer credit database

Combining the model with a credit score further segments risk, enabling lenders to confidently extend new credit

Delinquent Borrower Performance on Newly Originated Loan

Proof-of-Concept Delinquent Borrower Lending Model Deciles

CreditVision Score	1	2	3	4	5	6	7	8	9	10	Overall
> 664	15%	15%	13%	15%	14%	11%	10%	9%	8%	7%	8%
625-664	26%	23%	18%	17%	17%	15%	13%	12%	11%	9%	13%
585-624	29%	24%	22%	21%	22%	19%	17%	17%	15%	12%	19%
545-584	32%	27%	25%	26%	25%	23%	21%	19%	19%	16%	25%
< 545	37%	35%	33%	31%	30%	26%	23%	23%	20%	12%	32%

Our model show that lenders can confidently lend to borrowers with credit scores below 585 in the top deciles, as these borrowers have better delinquency performance on a newly originated loan.

Performance measured at 12 months, ever 1+ MIA on newly originated loan

Source: TransUnion South Africa consumer credit database

CONCLUSIONS

TransUnion's research indicates that extending additional liquidity to specific delinquent borrowers can yield favourable results. It highlights a segment of financially distressed borrowers who can improve, or 'cure' their existing delinquencies when provided with additional credit in the form of a new loan.

- Providing this credit prudently can create returns in profit and strengthen customer loyalty, offering a win-win situation for both lenders and borrowers.
- The challenge lies in accurately identifying these borrowers to ensure that extra credit supports, rather than exacerbates, their financial situation.
- Lenders can enhance the precision of their predictions by integrating trended and traditional credit attributes in their assessments. This combined approach can help identify borrowers who are likely to be profitable and benefit from a new loan, potentially improving lender interactions with distressed borrowers.